

Ann Arbor

Transportation Authority

*Financial Statements as of and for the
Years Ended September 30, 2004 and 2003 and
Additional Information for the Year Ended
September 30, 2004, Independent Auditors' Reports
Required by the Office of Management and Budget
Circular A-133 and Supplemental Schedule of
Expenditures of Federal Awards for the
Year Ended September 30, 2004, and
Independent Auditors' Reports*

AUDITING PROCEDURES REPORT

Issued under P.A. 2 of 1968, as amended. Filing is mandatory.

Local Government Type <input type="checkbox"/> City <input type="checkbox"/> Township <input type="checkbox"/> Village <input checked="" type="checkbox"/> Other		Local Government Name Ann Arbor Transportation Authority	County Washtenaw
Audit Date September 30, 2004	Opinion Date December 2, 2004	Date Accountant Report Submitted to State: January 12, 2005	

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

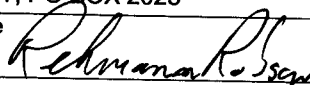
1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations

You must check the applicable box for each item below.

- | | |
|---|---|
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements. |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act. |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91], or P.A. 55 of 1982, as amended [MCL 38.1132]). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit. |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241). |
| <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No | 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95). |

We have enclosed the following:	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.	X		
Reports on individual federal financial assistance programs (program audits).			X
Single Audit Reports (ASLGU).	X		

Certified Public Accountant (Firm Name) REHMANN ROBSON GERALD J. DESLOOVER, CPA			
Street Address 5800 GRATIOT, PO BOX 2025		City SAGINAW	State MI
Accountant Signature 		Zip 48605	

ANN ARBOR TRANSPORTATION AUTHORITY

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REHMANN ROBSON

Certified Public Accountants

A member of THE REHMANN GROUP

An Independent Member of Baker Tilly International

INDEPENDENT AUDITORS' REPORT

December 2, 2004

To the Members of the Board of Directors of
Ann Arbor Transportation Authority
Ann Arbor, Michigan

We have audited the accompanying basic financial statements of Ann Arbor Transportation Authority (the "Authority") as of and for the years ended September 30, 2004 and 2003, as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Ann Arbor Transportation Authority as of September 30, 2004 and 2003, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our reported dated December 2, 2004 on our consideration of Ann Arbor Transportation Authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The information contained in the Schedule of Expenditures of Federal Awards, as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, as listed in the table of contents, is presented for purposes of additional analysis and is not a required part of the financial statements of the Ann Arbor Transportation Authority. Such information has been subjected to the auditing procedures applied in our audit of the 2004 basic financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the 2003 basic financial statements taken as a whole.

ANN ARBOR TRANSPORTATION AUTHORITY

MANAGEMENT DISCUSSION AND ANALYSIS YEARS ENDED SEPTEMBER 30, 2004 AND 2003

As management of the Ann Arbor Transportation Authority (the "Authority") in Ann Arbor, Michigan, we offer readers of the Authority's financial statements this narrative overview and analysis of the financial activities of the Authority for the fiscal year ended September 30, 2004. We encourage readers to consider the information in conjunction with the financial statements, related footnote disclosures and the required supplementary and additional information as listed in the table of contents.

Overview of the Financial Statements and Financial Analysis

The discussion is intended to present an overview of the Authority's financial performance for the years ended September 30, 2004 and 2003 and does not purport to make any statement regarding the future operations of the organization. While the Authority is an instrumentality of the State of Michigan, it is not a component of the State as defined by the Governmental Accounting Standards Board (GASB).

The annual report consists of the basic financial statements, which are the statement of net assets, statement of revenues, expenses and changes in net assets, and the statement of cash flows, prepared in accordance with GASB principles. This report also contains other supplementary information in addition to the basic financial statements, as required by the GASB and the State of Michigan Department of Treasury.

Effective with the year ended September 30, 2003, the Authority adopted GASB Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments* and Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Government: Omnibus*, and Statement No. 38, *Certain Financial Statement Note Disclosures*. The basic financial statements for the year ended September 30, 2003 have been audited and are included for comparative purposes.

Financial Highlights

The Authority's total assets increased from the prior year by \$6,462,000 (17.3%), primarily due to the purchase of eighteen buses for \$5,284,000, using Federal and State capital grants.

Current assets, other than cash and investments, increased by \$324,000 (10.7%) due to the increase in grants receivable for reimbursement of building renovation costs incurred late in the fiscal year.

Current liabilities increased by \$1,280,000 (13.6%) due to the increase in grants payable from the overpayment in the current year State of Michigan Formula Operating Assistance.

Non-operating revenue decreased \$857,000 (4.6%) due to many factors. Primarily, local revenue decreased due to a one-time gain of \$699,000 for forgiveness of debt in 2003. Also, Federal revenue decreased \$436,000 because we transferred the Rail Study Project to the Southeastern Michigan Council of Governments (SEMCOG) late last year.

Total expenses decreased \$227,000 (1.0%) primarily due to the decrease in consulting expenses of \$510,000 for the Rail Study project, as mentioned above.

Balance Sheets

The balance sheets includes all assets and liabilities. It is prepared under the "full accrual" basis of accounting, whereby revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when they occur, regardless of the timing of the related cash flows. Assets and liabilities are measured using the economic resources measurement focus. Capital assets are reported at historical cost less an allowance for depreciation.

A summary of the Authority's assets, liabilities and net assets at September 30, 2004 and 2003 follows (in thousands):

	2004	2003
Assets:		
Current assets	\$18,708	\$16,518
Capital assets, net	<u>25,043</u>	<u>20,770</u>
Total assets	<u>\$43,751</u>	<u>\$37,288</u>
Liabilities:		
Current liabilities	\$10,693	\$ 9,413
Noncurrent liabilities	<u>3,234</u>	<u>2,441</u>
Total liabilities	13,927	11,854
Net Assets:		
Invested in capital assets	25,043	20,770
Unrestricted	<u>4,781</u>	<u>4,664</u>
Total net assets	<u>29,824</u>	<u>25,434</u>
Total liabilities and net assets	<u>\$43,751</u>	<u>\$37,288</u>

At September 30, 2004, the Authority's total assets were \$43.75 million, compared to \$37.29 million at September 30 2003. The Authority's largest capital investments include buses and related equipment, net of depreciation, of \$12.5 million in 2004 and \$8.9 million in 2003 and the land and buildings, net of depreciation, of \$11.4 million in 2004 and \$10.5 in 2003. At September 30, 2004, the Authority had outstanding commitments relating to the replacement of the roof at the Authority's main facility for \$583,000. Funding for these expenditures is through Federal capital grants (80%) and state capital grants (20%).

The majority of the Authority's current liabilities are deferred revenue (\$6.3 million in 2004 and \$6.0 million in 2003), which is 75% (nine of twelve months) of the tax levied on the property in the City of Ann Arbor on July 1, 2004. The original property tax levy, approved by the voters in the City of Ann Arbor, Michigan, was 2.5 mills. However, the property tax levy is subject to the Headlee Amendment to the State of Michigan Constitution and has decreased in recent years and is currently 2.1 mills. The majority of the tax levy has been collected and the deferred revenue represents the portion that will be used to help fund operations from October 1, 2004 to June 30, 2005.

The total assets of the Authority exceeded its total liabilities by \$29,824,000 (net assets) as of September 30, 2004. Of this amount, \$4,781,000 (unrestricted net assets) may be used to fund future operations and meet future obligations of the Authority.

Statement of Revenues, Expenses, and Changes in Net Assets

A summary of the Authority's revenues, expenses and changes in net assets for the year ended September 30, 2004 follows (in \$1,000s):

	2004	2003
Operating revenues	\$ 3,194	\$ 3,175
Operating expenses	<u>23,436</u>	<u>23,662</u>
Operating loss	(20,242)	(20,487)
Non-operating revenues	<u>17,757</u>	<u>18,614</u>
Change in net assets before capital contributions	(2,485)	(1,873)
Capital contributions	<u>6,875</u>	<u>1,531</u>
Change in net assets	4,390	(342)
Net assets, beginning of year	<u>25,434</u>	<u>25,776</u>
Net assets, end of year	<u>\$29,824</u>	<u>\$25,434</u>

The Authority's primary sources of operating revenues are passenger fares collected in the farebox in each bus, sales of 30-day passes and tokens. Other operating revenues are special fares where someone else than the rider pays the fare, such as the successful go!pass and MRide programs.

Total operating expenses of \$23,436,000 include operations (\$14,568,000), vehicle and facility maintenance (\$4,593,000) and general administration (\$4,275,000). The largest portion of all expenses is for employee wages and fringe benefits of \$13,417,000 or 57.25% of all expenses.

Non-operating revenue include Federal, State and local operating assistance. The property tax revenue increased \$343,000 (4.5%) due to the increase in the taxable value of property in the City of Ann Arbor. However, State revenues decreased \$319,000 primarily due to the decrease in the percentage of formula operating assistance from 36.70% to 35.20%. Federal revenue decreased \$436,000 because we transferred the Rail Study Project to the Southeastern Michigan Council of Governments (SEMCOG) late last year. In the previous year, the Authority incurred \$515,000 in consulting and personnel expenses, which were covered by Federal, State and Local grants of \$508,000. These revenues and expenses were not repeated in the year ended September 30, 2004.

Capital contributions represent Federal and State grants for the purchase of replacement and new capital assets. During 2004, the Authority purchased eighteen buses and sold eleven buses. The purchase of these vehicles was funded by Federal (\$4,226,000) and state (\$1,061,000) capital grants. Most of the funds for capital assets are provided through Federal formula grants (Section 5307) administered by the Federal Transportation Administration. A portion of these Federal formula dollars can be used as operating assistance. In 2004 and 2003, the Authority used \$1,064,000 million and \$1,130,000, respectively for operating assistance, such as preventive maintenance, planning and capital cost of contracting.

Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the information provided in the basic financial statements.

Economic Factors and Next Year's Budget

The Authority receives significant operating assistance each year from the State of Michigan Comprehensive Transportation Fund. The source of these funds includes a portion of state gasoline taxes, vehicle related sales taxes, license fees and other taxes and fees. These funds are subject to legislative appropriation each year and the percentage of eligible expenses funded is subject to change during the year and subject to reconciliation and audit after the year has concluded.

For fiscal year 2005, the Board of Directors adopted a budget that used \$146,000 of unrestricted net assets to balance revenues with expenses. Subsequent to the 2005 budget's adoption, the State of Michigan reduced the formula operating assistance from 35.2% to 32.4%, reducing our expected non-operating revenues by \$524,000. The Authority expects the average price of ultra-low sulfur diesel fuel to be \$0.19 higher than originally budgeted, causing an anticipated increase of \$125,000 in fuel expense for fiscal year 2005.

The Authority also receives significant funding through the property tax levy on the citizens of the City of Ann Arbor. This amount has been increasing by 4.5% to 5.0% annually for the past 5 years and appears to be growing into the future. Ann Arbor has consistently been noted as a quality place to live with the University of Michigan and Eastern Michigan University along with hospitals and numerous cultural institutions in the area.

Request for Information

This financial report is designed to provide a general overview of the Authority's finances for all those with an interest in the transit provider's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Controller, Ann Arbor Transportation Authority, 2700 South Industrial Highway, Ann Arbor, Michigan 48104.

ANN ARBOR TRANSPORTATION AUTHORITY

BALANCE SHEETS

SEPTEMBER 30, 2004 AND 2003

ASSETS	2004	2003
CURRENT ASSETS:		
Cash (Note 2)	\$ 6,164,615	\$ 6,786,759
Investments (Note 2)	9,189,774	6,702,512
Accounts receivable, less allowance of \$0 in 2004 and \$300,000 in 2003	341,407	251,992
Grants receivable (Note 3)	1,480,672	822,327
Other receivables (Note 4)	313,297	601,931
Inventory	572,827	828,540
Prepaid expenses	645,033	524,352
Total current assets	18,707,625	16,518,413
CAPITAL ASSETS: (Note 5)		
Land and improvements	2,180,821	2,180,821
Park and Ride lot construction	1,477,419	1,133,335
Buildings and improvements	14,583,862	14,561,412
Equipment and other	29,532,291	25,746,498
Construction in progress (Note 13)	1,076,040	49,300
Total capital assets	48,850,433	43,671,366
Less accumulated depreciation	23,807,492	22,901,383
Net capital assets	25,042,941	20,769,983
TOTAL ASSETS	\$ 43,750,566	\$ 37,288,396
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Accounts payable	\$ 1,126,803	\$ 692,950
Grant refunds payable (Note 3)	2,240,184	1,612,231
Accrued payroll	321,581	256,623
Other accrued expenses	732,749	842,470
Deferred revenue (Note 6)	6,271,217	6,008,702
Total current liabilities	10,692,534	9,412,976
CONTINGENCIES (Note 8)		
POST-RETIREMENT BENEFIT OBLIGATION (Note 12)	3,234,054	2,441,329
Total liabilities	13,926,588	11,854,305
NET ASSETS:		
Invested in capital assets	25,042,941	20,769,983
Unrestricted	4,781,037	4,664,108
Total net assets	29,823,978	25,434,091
TOTAL LIABILITIES AND NET ASSETS	\$ 43,750,566	\$ 37,288,396

See notes to financial statements.

ANN ARBOR TRANSPORTATION AUTHORITY

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS YEARS ENDED SEPTEMBER 30, 2004 AND 2003

	2004	2003
OPERATING REVENUES (Note 9)	\$ 3,193,589	\$ 3,175,036
OPERATING EXPENSES (Notes 7, 9 and 12):		
Operations	14,567,771	13,961,796
Maintenance	4,592,992	4,818,110
General administration	4,274,766	4,882,348
Total operating expenses	<u>23,435,529</u>	<u>23,662,254</u>
OPERATING LOSS	(20,241,940)	(20,487,218)
NONOPERATING REVENUES:		
Local	8,976,983	9,079,155
State	6,783,071	7,102,266
Federal	<u>1,996,590</u>	<u>2,432,225</u>
Total nonoperating revenues	<u>17,756,644</u>	<u>18,613,646</u>
CHANGE IN NET ASSETS BEFORE CAPITAL CONTRIBUTIONS	(2,485,296)	(1,873,572)
CAPITAL CONTRIBUTIONS	<u>6,875,183</u>	<u>1,531,454</u>
CHANGE IN NET ASSETS	4,389,887	(342,118)
TOTAL NET ASSETS, BEGINNING OF YEAR	<u>25,434,091</u>	<u>25,776,209</u>
TOTAL NET ASSETS, END OF YEAR	<u>\$ 29,823,978</u>	<u>\$ 25,434,091</u>

See notes to financial statements.

ANN ARBOR TRANSPORTATION AUTHORITY

STATEMENTS OF CASH FLOWS YEARS ENDED SEPTEMBER 30, 2004 AND 2003

	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from transit operations	\$ 2,806,780	\$ 2,568,567
Payments for salaries and wages and fringe benefits	(12,524,572)	(12,426,712)
Payments to suppliers	(3,532,806)	(5,598,348)
Payments for claims and insurance	(939,996)	(622,392)
Payments for purchased transportation	(2,010,318)	(1,830,207)
Net cash used in operating activities	<u>(16,200,912)</u>	<u>(17,909,092)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Nonoperating revenue:		
Local	9,234,684	8,510,726
State	7,741,557	7,098,133
Federal	1,987,241	2,432,225
Net cash provided by noncapital financing activities	<u>18,963,482</u>	<u>18,041,084</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Acquisition and construction of capital assets	(6,957,046)	(2,668,323)
Capital contributed by state and federal grants	5,895,654	1,531,454
Proceeds from sale of equipment	20,353	10,416
Net cash used in capital and related financing activities	<u>(1,041,039)</u>	<u>(1,126,453)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of investment securities	(6,287,403)	(7,674,856)
Proceeds from sale and maturities of investment securities	3,804,607	12,647,160
Interest income	139,121	148,611
Net cash (used in) provided by investing activities	<u>(2,343,675)</u>	<u>5,120,915</u>
NET INCREASE (DECREASE) IN CASH	(622,144)	4,126,454
CASH AT BEGINNING OF YEAR	6,786,759	2,660,305
CASH AT END OF YEAR	<u>\$ 6,164,615</u>	<u>\$ 6,786,759</u>

See notes to financial statements.

ANN ARBOR TRANSPORTATION AUTHORITY

STATEMENTS OF CASH FLOWS (Continued) YEARS ENDED SEPTEMBER 30, 2004 AND 2003

	2004	2003
RECONCILIATION OF OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES:		
Operating loss	\$ (20,241,940)	\$ (20,487,218)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation	2,660,508	2,688,265
Changes in assets and liabilities which (used) provided cash:		
Receivables	15,330	(183,190)
Inventory	255,713	11,275
Prepaid expenses	(120,681)	(145,834)
Payables	482,196	(325,225)
Accrued payroll	64,958	44,225
Other accrued expenses	683,004	488,610
Total adjustments	<u>4,041,028</u>	<u>2,578,126</u>
NET CASH USED IN OPERATING ACTIVITIES	<u>\$ (16,200,912)</u>	<u>\$ (17,909,092)</u>

See notes to financial statements.

ANN ARBOR TRANSPORTATION AUTHORITY

NOTES TO FINANCIAL STATEMENTS YEARS ENDED SEPTEMBER 30, 2004 AND 2003

1. NATURE OF THE ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Nature of the Organization

The Ann Arbor Transportation Authority (the "Authority") is a governmental unit established under statutes of the State of Michigan to provide a mass transportation system within and beyond the corporate limits of the City of Ann Arbor.

The Authority is not included in the financial reporting entity of the City of Ann Arbor because the City does not have the ability to exercise significant oversight over the Authority. The Authority can independently generate revenue, adopt budgets and borrow funds. The members of the governing Board of Directors are appointed by the mayor of the City and confirmed by the City Council.

Significant Accounting Policies

Basis of Accounting - In accordance with Governmental Accounting Standards Board (GASB) No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting*, the Authority applies all applicable GASB pronouncements as well as all Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARB) issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

Investments are held primarily in certificates of deposit and in three pooled municipal investment trust funds. These trust funds consist of certificates of deposit, United States Treasury securities, repurchase agreements and commercial paper.

Revenues, Capital Grant Contributions and Deferred Revenue - Revenues are classified as operating and nonoperating revenues and capital contributions. Operating revenues include activities that have the characteristics of exchange transactions, such as passenger fares and special transit fares. Nonoperating revenues include activities that have the characteristics of nonexchange transactions, such as Federal and State operating grants, City of Ann Arbor tax levies, fees paid by other municipalities under purchase of service agreements, and interest income. Capital contributions are Federal and State grants designated for the purchase and/or construction of land, buildings and equipment are recognized as revenue and are included in the statement of revenues, expenses and changes in net assets.

The Authority recognizes as revenue only that portion of the City of Ann Arbor's tax levy for transit services which is attributable to the Authority's fiscal year. Accordingly, only one quarter of the tax levy and the inventory replacement tax for the period July 1 to June 30 is included as nonoperating revenues in the accompanying statements of revenues, expenses and net assets. The balance of the tax levy is recorded as deferred revenue. (See Note 6).

Vacation and Sick Pay - The Authority records expense for vacation and sick pay benefits when earned by the employees. The accrual for unused vacation and sick leave is reported as a current liability because there is no limit on how many earned vacation and sick days an employee can use in a year.

Inventory is stated at the lower of cost (first-in, first-out basis) or market.

Statement of Cash Flows - For purposes of this statement, the Authority considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents.

Capital Assets - Capital assets, which include land, buildings, vehicles and other equipment are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair value at the date of donation.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

Depreciation is computed using the straight-line method based on the estimated useful lives of 20 to 30 years for land improvements, of 6 to 30 years for buildings and improvements and of 3 to 12 years for equipment.

Net Assets are displayed in two components as follows:

Invested in Capital Assets - This consists of capital assets, net of accumulated depreciation.

Unrestricted - This consists of net assets that do not meet the definition of "invested in capital assets."

Use of Estimates - The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications - Certain amounts from the prior year have been reclassified to conform to the current year presentation.

New Accounting Pronouncements - During the year ended September 30, 2003, the Authority adopted the provisions of GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, and Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Government: Omnibus*, effective October 1, 2002. These statements changed the format and content of the Authority's financial statements, including the presentation of net assets, the preparation of the statement of cash flows on the direct method, and the inclusion of management's discussion and analysis.

2. CASH AND INVESTMENTS

The following is a reconciliation of deposit and investment balances as of September 30, 2004 and 2003:

Balance Sheet:

	<u>2004</u>	<u>2003</u>
Cash	\$ 6,164,615	\$ 6,786,759
Investments	<u>9,189,774</u>	<u>6,702,512</u>
Total	<u>\$ 15,354,389</u>	<u>\$13,489,271</u>

	<u>2004</u>	<u>2003</u>
Deposits and Investments:		
Bank deposits (checking, savings and certificate of deposit accounts) \$	8,750,862	\$ 7,361,714
Investment in government liquid asset fund accounts	6,596,657	6,120,687
Cash on hand	<u>6,870</u>	<u>6,870</u>
Total	<u>\$ 15,354,389</u>	<u>\$ 13,489,271</u>

Deposits - As of September 30, 2004 and 2003, the carrying amount of the Authority's cash deposits was \$8,750,862 and \$7,361,714, respectively, and the bank balance was \$8,881,774 and \$7,368,585, respectively (of which \$400,000 and \$300,000, respectively, was covered by Federal depository insurance). The difference is primarily due to outstanding checks.

Investments - The Authority's policy is to limit investments to the following:

- Certificates of deposit, depository receipts, and repurchase agreements (covered by direct obligations of the United States Treasury) of certain Ann Arbor financial institutions. The total investment (exclusive of checking accounts) in any financial institutions shall not exceed the lesser of twenty percent of that financial institution's capital and surplus or \$4,000,000.
- Bonds and other direct obligations of the United States or any agency thereof with a maturity of three years or less.
- Top rated commercial paper of corporations acquired through the bidding process or through the secondary market. Not more than \$500,000 may be invested in a single corporation.
- Governmental mutual funds which invest only in authorized investments for local units of government under state law and which offer daily liquidity.
- Investments are categorized into these three categories of credit risk:
 1. Insured or registered, or securities held by the government or its agent in the government's name.
 2. Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the government's name.
 3. Uninsured or unregistered, with securities held by the counterparty, or by its trust department or agent but not in the government's name.

For the years ended September 30, 2004 and 2003, the Authority's investments consisted of municipal investment funds totaling \$6,596,657 and \$6,120,687, respectively, which equals market value. In addition, the municipal investment trust funds have not been categorized to give an indication of the level of custodial credit risk assumed by the Authority at year-end since these investments are not evidenced by securities that exist in physical or book entry form.

3. GRANTS RECEIVABLE/GRANT REFUNDS PAYABLE

The Authority recognizes a receivable under approved grants as related project expenditures are incurred and the grant revenue earned. Grant refunds payable represent amounts to be returned to the grantor. The following grant amounts were outstanding at September 30:

	2004	2003
Michigan Department of Transportation:		
Buses and related equipment	\$ 14,827	\$ 81,203
Rideshare program	13,046	5,264
Operating assistance	(2,194,465)	(1,578,405)
Planning	6,517	5,986
Transportation to Work (formerly Project Zero)	28,234	23,499
Ride Source	0	0
Building improvements	200,000	0
Park and Ride lot improvements	0	5,497
Rail Study	(2,700)	351,640
Federal Transit Administration:		
Buses and related equipment	59,437	62,564
Planning	51,034	47,884
Building improvements	860,832	0
Park and Ride lot improvements	0	6,336
Congestion Mitigation/Air Quality	200,816	151,694
Demonstration	0	44,024
Southeastern Michigan Council of Governments - Planning Grant	<u>2,910</u>	<u>2,910</u>
NET GRANTS RECEIVABLE (REFUNDS PAYABLE)	<u>\$ (759,512)</u>	<u>\$ (789,904)</u>
REMAINING UNEARNED BALANCES ON ABOVE GRANTS	<u>\$ 5,643,258</u>	<u>\$ 11,961,910</u>

The grants receivable/grant refunds payable are reported on the balance sheets as follows:

	2004	2003
Grants receivable	\$ 1,480,672	\$ 822,327
Grant refunds payable	<u>(2,240,184)</u>	<u>(1,612,231)</u>
Net grants receivable (refunds payable)	<u>\$ (759,512)</u>	<u>\$ (789,904)</u>

4. **OTHER RECEIVABLES**

Other receivables consist of the following amounts:

	2004	2003
City of Ann Arbor - tax levy	\$ 236,980	\$ 416,404
City of Ann Arbor - inventory replacement tax	74,574	74,574
Interest receivable	1,743	6,208
Workers' compensation insurance refund	<u>0</u>	<u>104,745</u>
Total	<u>\$ 313,297</u>	<u>\$ 601,931</u>

5. CAPITAL ASSETS

Capital asset activity during the fiscal year ended September 30, 2004 is as follows:

	Balance October 1	Additions	Deletions	Balance September 30
Capital assets not being depreciated:				
Land and improvements	\$ 2,180,821	\$ -	\$ -	\$ 2,180,821
Construction in progress	49,300	1,076,040	49,300	1,076,040
Total capital assets not being depreciated	<u>2,230,121</u>	<u>1,076,040</u>	<u>49,300</u>	<u>3,256,861</u>
Capital assets being depreciated:				
Park and ride lot construction	1,133,335	344,084		1,477,419
Buildings	14,561,412	22,450		14,583,862
Vehicles and related equipment	18,446,172	5,407,116	1,684,979	22,168,309
Radio and telephone systems	202,886	8,700	7,720	203,866
Fare collection equipment	1,003,900	-		1,003,900
Maintenance equipment	478,611	965	2,611	476,965
Office equipment and furniture	1,449,438	82,997	7,866	1,524,569
Passenger shelters	683,847	40,414	-	724,261
Other	196,630	-	9,380	187,250
Advanced operating system	3,285,014	-	41,843	3,243,171
Total capital assets being depreciated	<u>41,441,245</u>	<u>5,906,726</u>	<u>1,754,399</u>	<u>45,593,572</u>
Less accumulated depreciation:				
Park and ride lot construction	299,918	66,919	-	366,837
Buildings	7,043,361	505,720	-	7,549,081
Vehicles and related equipment	10,678,376	1,648,581	1,684,979	10,641,978
Radio and telephone systems	130,043	13,931	7,720	136,254
Fare collection equipment	302,345	84,108	-	386,453
Maintenance equipment	217,885	43,117	2,611	258,391
Office equipment and furniture	911,180	120,874	7,866	1,024,188
Passenger shelters	244,404	58,976	-	303,380
Other	174,211	5,252	9,380	170,083
Advanced operating system	2,899,660	113,030	41,843	2,970,847
Total accumulated depreciation	<u>22,901,383</u>	<u>2,660,508</u>	<u>1,754,399</u>	<u>23,807,492</u>
Total capital assets being depreciated, net	<u>18,539,862</u>	<u>3,246,218</u>		<u>21,786,080</u>
TOTAL CAPITAL ASSETS, NET	<u>\$ 20,769,983</u>	<u>\$ 4,322,258</u>	<u>\$ 49,300</u>	<u>\$ 25,042,941</u>

5. CAPITAL ASSETS (Continued)

Capital asset activity during the fiscal year ended September 30, 2003 is as follows:

	Balance October 1	Additions	Deletions	Balance September 30
Capital assets not being depreciated:				
Land and improvements	\$ 2,180,821	-	-	\$ 2,180,821
Construction in progress	444,796	23,580	419,076	49,300
Total capital assets not being depreciated	<u>2,625,617</u>	<u>23,580</u>	<u>419,076</u>	<u>2,230,121</u>
Capital assets being depreciated:				
Park and ride lot construction	1,128,615	4,720	-	1,133,335
Buildings	13,520,638	\$ 1,040,774	-	14,561,412
Vehicles and related equipment	18,808,025	948,244	1,310,097	18,446,172
Radio and telephone systems	202,208	678	-	202,886
Fare collection equipment	1,003,900	-	-	1,003,900
Maintenance equipment	463,641	20,438	5,468	478,611
Office equipment and furniture	1,236,495	392,433	179,490	1,449,438
Passenger shelters	345,421	338,426	-	683,847
Other	196,630	-	-	196,630
Advanced operating system	2,966,908	318,106	-	3,285,014
Total capital assets being depreciated	<u>39,872,481</u>	<u>3,063,819</u>	<u>1,495,055</u>	<u>41,441,245</u>
Less accumulated depreciation:				
Park and ride lot construction	241,814	58,104	-	299,918
Buildings	6,564,405	478,956	-	7,043,361
Vehicles and related equipment	10,440,085	1,497,946	1,259,655	10,678,376
Radio and telephone systems	116,894	13,149	-	130,043
Fare collection equipment	218,237	84,108	-	302,345
Maintenance equipment	181,301	42,052	5,468	217,885
Office equipment and furniture	937,028	112,094	137,942	911,180
Passenger shelters	205,803	38,601	-	244,404
Other	168,959	5,252	-	174,211
Advanced operating system	2,541,657	358,003	-	2,899,660
Total accumulated depreciation	<u>21,616,183</u>	<u>2,688,265</u>	<u>1,403,065</u>	<u>22,901,383</u>
Total capital assets being depreciated, net	<u>18,256,298</u>	<u>375,554</u>	<u>91,990</u>	<u>18,539,862</u>
TOTAL CAPITAL ASSETS, NET	<u>\$ 20,881,915</u>	<u>\$ 399,134</u>	<u>\$ 511,066</u>	<u>\$ 20,769,983</u>

6. DEFERRED REVENUE

Deferred revenue represents amounts not earned, and consists of the following amounts:

	2004	2003
City of Ann Arbor - tax levy	\$6,215,284	\$5,949,272
City of Ann Arbor - inventory replacement tax	55,933	55,930
Local Grant	<u>0</u>	<u>3,500</u>
Total	<u>\$6,271,217</u>	<u>\$6,008,702</u>

7. EMPLOYEES PENSION PLAN

The Authority provides pension benefits for substantially all of its employees through a defined contribution plan called the Ann Arbor Transportation Authority Employees' Pension Plan ("Plan"). In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. Employees are eligible to participate after one year of employment. The Authority's contributions for each employee and interest allocated to the employee's account are fully vested after five years of employment. Authority contributions for, and interest forfeited by, employees who leave employment before five years of service are used to reduce the Authority's current year contribution requirement. Employees contribute 3% of their gross earnings to the plan. The Authority's contribution to the plan is 9% less forfeitures of the employee's gross earnings and amounted to \$719,000 and \$776,000 for the years ended September 30, 2004 and 2003, respectively. Total payroll and covered payroll was approximately \$9,461,000 and \$8,709,000 for 2004 and \$9,115,000 and \$8,628,000 for 2003.

The Authority's Board of Directors administers the Plan, and also establishes contribution requirements and approves any Plan amendments.

8. CONTINGENCIES

The Authority is a defendant in several pending personal injury lawsuits. In the opinion of management, the outcome of this litigation and other matters will not significantly affect the Authority's financial position or results of its operations.

9. SUBCONTRACT SERVICE

The Authority subcontracts with a taxi cab company to provide certain services. The Authority pays the cab company fees based on the level of service provided, and the cab company collects and retains the passenger fares as an advance against the monthly billings. Operating revenues and operating expenses include approximately \$297,400 and \$321,900 of fares for these services in the years ended September 30, 2004 and 2003, respectively.

10. COST ALLOCATION PLANS

The Bus Transit Division of the Michigan Department of Transportation has approved the Authority's cost allocation plans for all material allocated expenses. These allocation plans have been used in the preparation of the financial statements.

11. INFORMATIONAL SUMMARY OF PROJECTED REVENUES, EXPENDITURES AND METHOD OF FINANCING CAPITAL PROJECTS

The Authority has prepared and made available for inspection the informational summary of projected revenues, expenditures and capital project costs recommended in Section 15, subsection 1(h), Act 621, PA 1978, as amended, (MCLA 141.435) (MSA 5.3228 (35)) and as required in Act 51, 10e (1) (d) (vii).

12. POST EMPLOYMENT RETIREMENT BENEFITS

The Authority provides contributory and noncontributory medical benefits and basic life insurance coverage for eligible retirees and their spouses. The benefits for bargaining employees are specified by union contract while the Board of Directors establishes those for non-bargaining employees. Bargaining and non-bargaining employees who retire at or after age 62 with at least 15 years of service are eligible for medical coverage. Retirees have the option to select an alternate medical insurance carrier and be reimbursed for such coverage at a rate of up to 130% of that year's core HMO single person premium. Retiree's spouses are eligible to receive 50% of the monthly premium for the core HMO single person premium toward medical coverage. Bargaining and non-bargaining employees who retire at or after age 59-1/2 with at least 15 years of service are eligible for life insurance coverage in the amount of \$30,000 until age 64, \$20,000 from age 65 to 69, \$15,000 from age 70 to 74 and \$10,000 age 75 and over.

The Authority has elected to recognize the expense related to these benefits on an actuarially determined basis, to better match the expense of the benefits with the period in which employees earn the benefits. The actuarial cost method used is the projected unit credit cost method, which is a "benefits/years of service approach." Under this method the accumulated post retirement benefit obligation is the sum of (a) the actuarial present value of benefits of retirees and (b) a proportionate amount of the actuarial present values of the benefits to be paid during the retired life of current active employees with the proration based on years of service and retirement eligibility date. A health care cost trend of 10.0% and 7.0% in 2002 and 2001, respectively, (decreasing by .5% per year to an ultimate rate of 5% per annum), a discount rate of 6.5% per annum in 2002 and 2001, and the 1983 Group Annuity Mortality tables are used for the actuarial calculation.

There are 205 active plan participants. The retirement benefit expense for fiscal 2004 and 2003 determined on the accrual basis is \$792,725 and \$321,589. The total actuarial liability at September 30, 2004 and 2003 is \$3,234,054 and \$2,441,329, respectively. The Authority does not advance fund the retirement benefits. Individual premiums and claims are paid as they are incurred.

13. COMMITMENTS

At September 30, 2004, the Authority had outstanding commitments relating to the replacement of the roof at the Authority's main facility for approximately \$583,000. Also, the Authority had a commitment for the purchase of six passenger shelters for approximately \$27,000, delivered during October 2004. Funding for these expenditures is through Federal capital grants (80%) and State capital grants (20%).

* * * * *



REHMANN ROBSON

Certified Public Accountants

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INDEPENDENT AUDITORS' REPORT ON ADDITIONAL INFORMATION

December 2, 2004

To the Members of the Board of Directors of
Ann Arbor Transportation Authority
Ann Arbor, Michigan

We have audited the basic financial statements of Ann Arbor Transportation Authority, as of and for the years ended September 30, 2004 and 2003, and have issued our report thereon dated December 2, 2004. Our audits were performed for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying additional information is presented for the purpose of additional analysis and is not a required part of the basic financial statements. This additional information on pages 20 - 28 is the responsibility of the management of Ann Arbor Transportation Authority. Such information has been subjected to the auditing procedures applied in our audits of the basic financial statements, and, in our opinion, is fairly stated, in all material respects when considered in relation to the basic financial statements taken as a whole.

The schedules of mileage data and of vehicle hours and passengers on pages 29 and 30 are the responsibility of the Authority's management. Such schedules have not been subjected to the auditing procedures applied in our audits of the basic financial statements and, accordingly, we express no opinion on them.

Rehmann Robson

ANN ARBOR TRANSPORTATION AUTHORITY

ADDITIONAL INFORMATION - SCHEDULE OF OPERATING REVENUES YEARS ENDED SEPTEMBER 30, 2004 AND 2003

OPERATING REVENUES:	2004	2003
Passenger fares:		
Urban	\$ 3,041,488	\$ 3,150,898
Nonurban	<u>152,101</u>	<u>24,138</u>
TOTAL OPERATING REVENUES	<u>\$ 3,193,589</u>	<u>\$ 3,175,036</u>

See Independent Auditors' Report on Additional Information.

ANN ARBOR TRANSPORTATION AUTHORITY

ADDITIONAL INFORMATION - SCHEDULE OF OPERATING EXPENSES YEAR ENDED SEPTEMBER 30, 2004 WITH COMPARATIVE TOTALS FOR 2003

	Operations	Maintenance	General Administration	2004 Total	2003 Total
LABOR:					
Operators' salaries and wages	\$ 4,506,234			\$ 4,506,234	\$ 4,192,308
Other salaries and wages	658,874	\$ 1,649,884	\$ 1,079,019	3,387,777	3,318,181
FRINGE BENEFITS	3,676,261	1,206,579	640,296	5,523,136	5,339,189
SERVICES:					
Advertising fees			85,082	85,082	102,026
Other services		628,959	429,877	1,058,836	2,123,248
Auditing fees			22,000	22,000	21,300
MATERIALS AND SUPPLIES CONSUMED:					
Fuel and lubricants	861,640	3,572		865,212	838,132
Tires and tubes	54,638			54,638	72,118
Materials and supplies	6,733	1,060,881	365,397	1,433,011	1,283,261
UTILITIES			338,174	338,174	429,476
CASUALTY AND LIABILITY COSTS:					
Premiums for public liability and property damage insurance	445,983			445,983	412,885
Other casualty and liability costs			236,121	236,121	175,921
PURCHASED TRANSPORTATION	2,407,712			2,407,712	2,253,486
MISCELLANEOUS EXPENSES:					
Travel and meetings			74,786	74,786	88,587
Advertising and promotion media			104,491	104,491	129,756
Other			198,508	198,508	178,782
LEASES AND RENTALS	31,070		2,250	33,320	15,333
DEPRECIATION	<u>1,918,626</u>	<u>43,117</u>	<u>698,765</u>	<u>2,660,508</u>	<u>2,688,265</u>
TOTAL OPERATING EXPENSES	<u>\$ 14,567,771</u>	<u>\$ 4,592,992</u>	<u>\$ 4,274,766</u>	<u>\$ 23,435,529</u>	<u>\$ 23,662,254</u>

See Independent Auditors' Report on Additional Information.

ANN ARBOR TRANSPORTATION AUTHORITY

ADDITIONAL INFORMATION - SCHEDULE OF NONOPERATING REVENUES (EXPENSES) YEARS ENDED SEPTEMBER 30, 2004 AND 2003

	2004	2003
LOCAL NONOPERATING REVENUE (EXPENSE):		
Purchase of service agreements:		
City of Ypsilanti	\$ 187,284	\$ 172,027
City of Milan	7,800	5,200
Pittsfield Township	109,825	105,234
Superior Township	18,541	19,595
Ypsilanti Township	189,225	182,458
Village of Dexter		7,232
Northfield's Human Services	15,000	
Total	527,675	491,746
City of Ann Arbor - tax levy	8,045,246	7,701,811
City of Ann Arbor - inventory replacement tax	74,574	74,574
Total	8,119,820	7,776,385
Interest income	139,121	148,611
Local share of Rail Study project		44,057
Gain on forgiveness of debt		698,864
Pfizer Art Grant	3,500	
Recovery from Federal Bankruptcy Court - Fare Collection System	140,756	
Other revenue	995	1,066
Gain (Loss) on sale of equipment	45,116	(81,574)
Total local nonoperating revenue (expense)	8,976,983	9,079,155
STATE AND FEDERAL NONOPERATING REVENUE:		
State of Michigan operating grants:		
Formula operating assistance - urban (Act 51)	6,409,125	6,602,457
Formula operating assistance - non-urban (Act 51)	158,239	99,956
Rideshare program	41,001	30,335
Planning program	20,531	25,986
Capital cost of contracting	25,000	30,474
Preventive maintenance	200,000	200,000
Transportation to Work (formerly Project Zero)	46,544	62,612
Prior years formula adjustments - urban and nonurban	(201,944)	(90,718)
Rail Study project (State portion)		51,507
RideSource (State portion)		5,386
Guaranteed Ride Home Reimbursements	1,440	
Special services	83,135	84,271
Total	6,783,071	7,102,266
Federal operating grants:		
Unified planning program passed through SEMCOG (Section 5303)	49,440	49,440
Planning (Section 5307)	164,249	207,883
Federal operating assistance (Section 5311) - passed through the State of Michigan	41,024	24,989
Capital cost of contracting (Section 5307)	99,998	121,895
Congestion Mitigation/Air Quality (Section 5307)	841,879	614,289
Preventive maintenance (Section 5307)	800,000	800,000
Federal Demonstration Program (Section 5307)		180,131
Rail Study project (Federal portion)		412,053
Ride Source (Section 5313(b))		21,545
Total	1,996,590	2,432,225
Total state and federal nonoperating revenue	8,779,661	9,534,491
TOTAL NONOPERATING REVENUES	\$ 17,756,644	\$ 18,613,646

See Independent Auditors' Report on Additional Information.

ANN ARBOR TRANSPORTATION AUTHORITY

ADDITIONAL INFORMATION

SCHEDULE OF FEDERAL AND STATE INTEREST IN CAPITAL ASSETS YEARS ENDED SEPTEMBER 30, 2004 AND 2003

	2004	2003
FEDERAL AND STATE INTEREST IN CAPITAL ASSETS:		
Balance, beginning of year	\$ 17,136,069	\$ 18,024,143
Contributions - Federal and State capital grants	6,875,183	1,531,454
Recovery from Bankruptcy Court - Fare Collection System	140,751	
Disposals - Federal and State interest		(41,633)
Depreciation on assets purchased with Federal and State capital grants	(2,359,745)	(2,377,895)
Balance, end of year	<u>\$ 21,792,258</u>	<u>\$ 17,136,069</u>
Detail of Federal and State interest in capital assets at September 30		
Federal government	\$ 35,025,596	\$ 30,788,305
State of Michigan	7,760,982	6,701,311
Total	42,786,578	37,489,616
Less accumulated depreciation on contributed assets	<u>20,994,320</u>	<u>20,353,547</u>
Net Federal and State interest in capital assets	21,792,258	17,136,069
Net local interest in capital assets	<u>3,250,683</u>	<u>3,633,914</u>
Net assets invested in capital assets	<u>\$ 25,042,941</u>	<u>\$ 20,769,983</u>

See Independent Auditors' Report on Additional Information.

ANN ARBOR TRANSPORTATION AUTHORITY

ADDITIONAL INFORMATION - SCHEDULE OF OPERATING EXPENSES BY CONTRACT AND GENERAL OPERATIONS YEAR ENDED SEPTEMBER 30, 2004, WITH COMPARATIVE TOTALS FOR 2003

	Capital Cost Of Contracting 2002-0007/Z8	Special Services 2002-0007/Z9	Contract				Rideshare Program 2003-0034 2004-0032	Non Urban Operations (Sec. 6311: 2002-0007/Z11)	Urban Operations		2004 Total	2003 Total
			Planning 2002-0007/Z8 2002-0007/Z12	Preventive Maintenance 2002-0007/Z12	Transportation to Work 2002-0007/Z10	Guaranteed Ride Home			Paratransit	Fixed Route		
TOTAL OPERATING EXPENSES:												
Labor			\$ 24,949	\$ 200,000	\$ 3,176		\$ 18,761	\$ 24,871	\$ 535,590	\$ 7,086,664	\$ 7,894,011	\$ 7,510,489
Fringe benefits			12,210		1,588		5,730	21,446	342,217	5,139,945	5,523,136	5,339,189
Services			3,903				6,705		75,272	1,080,038	1,165,918	2,246,574
Materials and supplies							4,704		153,065	2,195,092	2,352,861	2,193,511
Utilities									21,472	316,702	338,174	429,476
Casualty and liability costs									45,193	636,911	682,104	588,806
Purchased transportation	\$ 25,000	\$ 162,263			41,780	\$ 1,440	508	\$ 336,133	1,840,588		2,407,712	2,253,486
Miscellaneous							4,593		24,049	349,143	377,785	397,125
Leases and rentals									2,208	31,112	33,320	15,333
Depreciation									184,905	2,475,603	2,660,508	2,688,265
Total operating expenses	25,000	162,263	41,062	200,000	46,544	1,440	41,001	382,450	3,224,559	19,311,210	23,435,529	23,662,254
Less ineligible expenses								7,800	256,342	4,076,132	4,340,274	4,394,897
TOTAL	\$ 25,000	\$ 162,263	\$ 41,062	\$ 200,000	\$ 46,544	\$ 1,440	\$ 41,001	\$ 374,650	\$ 2,968,217	\$ 15,235,078	\$ 19,095,255	\$ 19,267,357

See Independent Auditors' Report on Additional Information

ANN ARBOR TRANSPORTATION AUTHORITY

ADDITIONAL INFORMATION - SCHEDULE OF COMPUTATIONS FOR NET ELIGIBLE COSTS COMPUTATIONS OF GENERAL OPERATIONS FOR STATE OPERATING ASSISTANCE YEAR ENDED SEPTEMBER 30, 2004

	Non Urban Operations	Urban Operations	
		Paratransit	Fixed Route
EXPENSES:			
Labor	\$ 24,871	\$ 535,590	\$ 7,086,664
Fringe benefits	21,446	342,217	5,139,945
Services		75,272	1,080,038
Materials and supplies		153,065	2,195,092
Utilities		21,472	316,702
Casualty and liability costs		45,193	636,911
Purchased transportation	336,133	1,840,588	
Miscellaneous		24,049	349,143
Leases and rentals		2,208	31,112
Depreciation		184,905	2,475,603
Total expenses	382,450	3,224,559	19,311,210
LESS INELIGIBLE EXPENSES:			
Items reimbursed by Federal grants (Note A):			
Capital Cost of Contracting (Section 5307)		99,998	
Congestion Mitigation/Air Quality (Section 5307)			841,879
Planning (Section 5307)			164,249
Preventative Maintenance (Section 5307)			800,000
Unified planning program, includes local share (Section 5303)			61,800
Total		99,998	1,867,928
Depreciation and amortization (Note C)		156,344	2,203,401
Miscellaneous expense (Note D)	7,800		3,808
Total	7,800	256,342	4,075,137
Net eligible expenses			15,236,073
LESS PROJECT REVENUE -			
Miscellaneous income (Note E)			995
TOTAL ELIGIBLE FOR STATE OPERATING ASSISTANCE	\$ 374,650	\$ 2,968,217	\$ 15,235,078
State operating assistance (42.236619648% for nonurban, 35.208599129% for urban operations)	\$ 158,239	\$ 1,045,068	\$ 5,364,058
Federal (Section 5311) (10.95% for nonurban operations)	41,024		
TOTAL	\$ 199,264	\$ 1,045,068	\$ 5,364,058

(Continued)

See Independent Auditors' Report on Additional Information.

ANN ARBOR TRANSPORTATION AUTHORITY

ADDITIONAL INFORMATION - NOTES TO SCHEDULE OF COMPUTATIONS FOR NET ELIGIBLE COSTS COMPUTATIONS OF GENERAL OPERATIONS FOR STATE OPERATING ASSISTANCE YEAR ENDED SEPTEMBER 30, 2004

A. ITEMS REIMBURSED BY FEDERAL GRANTS

Items reimbursed directly by Federal grants are deducted from total expenses in arriving at the net eligible expense total.

B. ITEMS REIMBURSED BY STATE OF MICHIGAN GRANTS

Items reimbursed by State of Michigan grants are deducted from total expenses in arriving at net eligible expenses total.

C. DEPRECIATION AND AMORTIZATION

Depreciation and amortization incurred on assets funded with State and Federal grants is an ineligible expense pursuant to State of Michigan regulations.

D. MISCELLANEOUS EXPENSE

The amounts disallowed represent a percentage of the annual dues paid to the American Public Transit Association and the Michigan Public Transit Association. It was determined that these organizations devote a portion of their efforts, 16.0% and 7.4%, respectively, to influencing legislation which is not eligible for reimbursement according to OMB Circular A-87.

E. PROJECT REVENUE - MISCELLANEOUS INCOME

Miscellaneous income used to reduce net eligible expenses represents other miscellaneous income.

(Concluded)

See Independent Auditors' Report on Additional Information.

ANN ARBOR TRANSPORTATION AUTHORITY

ADDITIONAL INFORMATION - SCHEDULE OF FINANCIAL ASSISTANCE - FEDERAL AND STATE CAPITAL CONTRIBUTIONS

YEAR ENDED SEPTEMBER 30, 2004

Federal Grantor/Pass Through Grantor/Program Title	Federal CFDA Number	State Grantor Number	Program Or Award Amount	Federal Revenue	State Revenue	Disbursements/ Expenditures	Amount Remaining
U.S. Department of Transportation:							
Direct assistance:							
Capital assistance:							
(MI90-0354)	20.507	N/A	1,819,622	\$ 1,381,798		\$ 1,381,798	\$ 1
(MI90-0380)	20.507	N/A	3,466,105	564,090		564,090	1,913,603
(MI90-0403)	20.507	N/A	4,612,002	3,535,970		3,535,970	1,073,004
(MI90-0428)	20.507	N/A	<u>984,000</u>	<u>27,395</u>		<u>27,395</u>	<u>956,605</u>
Total			10,881,729	5,509,253		5,509,253	3,943,213
Michigan Department of Transportation:							
Capital assistance	N/A	2001-0484	446,000		357,474	357,474	
Capital assistance	N/A	2002-007/Z4	857,000		132,822	132,822	712,878
Capital assistance	N/A	2002-007/Z8	1,138,000		868,785	868,785	268,458
Capital assistance	N/A	2002-007/Z12	<u>238,592</u>		<u>6,849</u>	<u>6,849</u>	<u>231,743</u>
Total			<u>2,679,592</u>		<u>1,365,930</u>	<u>1,365,930</u>	<u>1,213,079</u>
TOTAL CAPITAL ASSISTANCE			<u>\$ 13,561,321</u>	<u>\$ 5,509,253</u>	<u>\$ 1,365,930</u>	<u>\$ 6,875,183</u>	<u>\$ 5,156,292</u>

See Independent Auditors' Report on Additional Information.

ANN ARBOR TRANSPORTATION AUTHORITY

ADDITIONAL INFORMATION - SCHEDULE OF FINANCIAL ASSISTANCE - FEDERAL AND STATE OPERATING REVENUES YEAR ENDED SEPTEMBER 30, 2004

Federal Grantor/Pass Through Grantor/Program Title	Federal CFDA Number	State Grantor Number	Program or Award Amount	Federal Revenue	State Revenue	Disbursements/ Expenditures	Amount Remaining
U. S. Department of Transportation - State and federal operating assistance computations based on operating expense -							
Direct assistance:							
Unified Planning Program (Section 5303)	20.505	4005	\$ 49,440	\$ 49,440			
Planning (Section 5307) (MI90-X403)	20.507		160,000	112,115			\$ 1
Planning (Section 5307) (MI90-X428)	20.507		240,000	52,134			187,866
Capital cost of contracting (Section 5307) (MI90-X403)	20.507		99,998	99,998			
Capital cost of contracting (Section 5307) (MI90-X428)	20.507		160,000				160,000
Congestion Mitigation/Air Quality (Section 5307) (MI90-X321)	20.507		348,000	50,000			
Congestion Mitigation/Air Quality (Section 5307) (MI90-X408)	20.507		1,107,000	791,879			19,297
Preventive Maintenance (Section 5307) (MI90-X428)	20.507		800,000	800,000			
Nonurban Areas, Passed through M DOT (Section 5311)	20.509	2002-0007/Z11		41,024			
Michigan Department of Transportation:							
Operating assistance - Act 51 Urban	N/A				\$ 6,409,125	22,553,175	
Operating assistance - Act 51 Non-Urban	N/A				158,239	382,450	
Prior year formula adjustments	N/A				(201,944)		
Ridesharing Program		2004-0032	42,800		28,536	28,536	
Ridesharing Program		2003-0034	42,800		12,465	12,465	
Special Services		2002-0007/Z9	83,135		83,135	144,857	
Planning		2002-0007/Z8	20,000		14,014	28,028	
Planning		2002-0007/Z12	30,000		6,517	13,034	23,483
Capital cost of contracting		2002-0007/Z8	40,000		25,000	25,000	15,000
Capital cost of contracting		2002-0007/Z12	40,000				40,000
Preventive Maintenance		2002-0007/Z12	200,000		200,000	200,000	
Guaranteed Ride Home					1,440	1,440	
Transportation to Work (formerly Project Zero)		2002-0007/Z10	58,575		46,544	46,544	12,031
Transportation to Work		2002-0007/Z13	29,288				29,288
TOTAL OPERATING ASSISTANCE				\$ 1,996,590	\$ 6,783,071	\$ 23,435,529	\$ 486,966
STATE PASS-THROUGH - Special Services					\$ 78,008	\$ 78,008	

See Independent Auditors' Report on Additional Information.

ANN ARBOR TRANSPORTATION AUTHORITY

ADDITIONAL INFORMATION - SCHEDULE OF MILEAGE DATA (UNAUDITED) YEAR ENDED SEPTEMBER 30, 2004

	Public Transportation Mileage		
	Urban	Non-Urban	Charter
FIXED ROUTE:			
First quarter	643,620		
Second quarter	627,066		
Third quarter	636,131		
Fourth quarter	641,932		
Subtotal	2,548,749		
DEMAND - RESPONSE:			
First quarter	29,564		
Second quarter	29,308		
Third quarter	30,146		
Fourth quarter	25,077		
Subtotal	114,095		
CONTRACTED SERVICE:			
First quarter	301,334		
Second quarter	294,272		
Third quarter	301,811		
Fourth quarter	313,585		
Subtotal	1,211,002		
TOTAL	3,873,846		

See Independent Auditors' Report on Additional Information.

ANN ARBOR TRANSPORTATION AUTHORITY

ADDITIONAL INFORMATION - SCHEDULE OF VEHICLE HOURS AND PASSENGERS (UNAUDITED) YEAR ENDED SEPTEMBER 30, 2004

	Vehicle Hours	Passengers			
		Total	Regular	Senior	Disabled
FIXED ROUTE:					
First quarter	45,722	1,028,276	965,767	35,784	26,725
Second quarter	44,546	1,050,465	996,461	32,291	21,713
Third quarter	45,190	957,978	896,255	37,572	24,151
Fourth quarter	45,602	1,151,345	1,104,992	28,680	17,673
Subtotal	181,060	4,188,064	3,963,475	134,327	90,262
Percent		100.00 %	94.64 %	3.21 %	2.16 %
DEMAND - RESPONSE:					
First quarter	3,351	4,578			4,578
Second quarter	3,322	4,916			4,916
Third quarter	3,417	4,829			4,829
Fourth quarter	2,842	4,128			4,128
Subtotal	12,932	18,451			18,451
Percent		100.00 %			100.00 %
CONTRACTED SERVICE:					
First quarter	20,472	48,640	9,942	13,465	25,233
Second quarter	20,071	47,313	9,114	13,220	24,979
Third quarter	20,795	45,126	9,029	12,916	23,181
Fourth quarter	21,599	42,452	9,729	10,816	21,907
Subtotal	82,937	183,531	37,814	50,417	95,300
Percent		100.00 %	20.60 %	27.47 %	51.93 %
TOTAL	276,929	4,390,046	4,001,289	184,744	204,013
PERCENT		100 %	91.14%	4.21%	4.65 %

See Independent Auditors' Report on Additional Information.

ANN ARBOR TRANSPORTATION AUTHORITY

SUPPLEMENTAL SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS YEAR ENDED SEPTEMBER 30, 2004

Federal Grantor/Pass Through Grantor/Program Title	Catalog of Federal Domestic Assistance Number	Pass- Through Grantor's Number	Program or Award Amount	Current Year Expenditures
Transit Capital Grant Cluster -				
U.S. Department of Transportation - Federal				
Transit Administration:				
Federal Transit Capital and Operating Assistance Formula				
Grants:				
Capital, Planning and Operating Grant MI90-X354	20.507		\$ 1,904,000	\$ 1,381,798
Capital, Planning and Operating Grant MI90-X380	20.507		3,988,000	564,090
Capital, Planning and Operating Grant MI90-X403	20.507		5,672,000	3,748,083
Capital, Planning and Operating Grant MI90-X428	20.507		2,184,000	879,529
Congestion Mitigation/Air Quality Grant MI90-X321	20.507		222,000	50,000
Congestion Mitigation/Air Quality Grant MI90-X408	20.507		1,107,000	<u>791,879</u>
Subtotal - CFDA 20.507				7,415,379
Public Transportation for Nonurbanized Areas -				
Passed-Through Michigan Department of Transportation				
Operating Assistance - Section 5311	20.509	2002-007/Z11		41,024
Federal Transit Technical Studies Grant - Passed-Through				
Southeastern Michigan Council of Governments - Planning				
Grant	20.505	4005	49,440	<u>49,440</u>
Total Federal Expenditures of Federal Awards				<u>\$ 7,505,843</u>



REHMANN ROBSON

Certified Public Accountants

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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

December 2, 2004

To the Members of the Board of Directors of
Ann Arbor Transportation Authority
Ann Arbor, Michigan

We have audited the basic financial statements of the Ann Arbor Transportation Authority (the "Authority") as of and for the years ended September 30, 2004 and 2003, and have issued our report thereon dated December 2, 2004. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audits, we considered the Authority's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

However, we noted certain matters involving the internal control over financial reporting that we have reported to the management of the Authority in a separate letter dated December 2, 2004.

This report is intended solely for the information and use of the Board of Directors, management, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



REHMANN ROBSON

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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO A MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

December 2, 2004

To the Members of the Board of Directors of
Ann Arbor Transportation Authority
Ann Arbor, Michigan

Compliance

We have audited the compliance of the Ann Arbor Transportation Authority (the "Authority") with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133, *Compliance Supplement* that are applicable to its major federal program for the year ended September 30, 2004. The Authority's major federal program is identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the Authority's management. Our responsibility is to express an opinion on the Authority's compliance based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Authority's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Authority's compliance with those requirements.

In our opinion, the Authority complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended September 30, 2004.

Internal Control Over Compliance

The management of the Authority is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Authority's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

However, we noted certain matters involving the internal control over financial reporting that we have reported to the management of the Authority in a separate letter dated December 2, 2004.

This report is intended solely for the information and use of the Board of Directors, management, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



ANN ARBOR TRANSPORTATION AUTHORITY

SCHEDULE OF FINDINGS AND QUESTIONED COSTS YEAR ENDED SEPTEMBER 30, 2004

PART I – SUMMARY OF AUDITORS' RESULTS

1. The Independent auditors' report on the financial statements expressed an unqualified opinion.
2. There were no reportable conditions in internal control over financial reporting that were identified.
3. No instance of noncompliance considered material to the financial statements was disclosed by the audit.
4. There were no reportable conditions in internal control over compliance with requirements applicable to the major federal awards program that were identified.
5. The independent auditors' report on compliance with requirements applicable to the major federal award program expressed an unqualified opinion.
6. The audit disclosed no findings required to be reported by OMB Circular A-133.
7. The Authority's major program is:

Name of Cluster	CFDA Number
Federal Transit Capital and Operating Assistance Grants	20.507

8. A threshold of \$300,000 was used to distinguish between Type A and Type B programs as those terms are defined in OMB Circular A-133.
9. The Organization did qualify as a low-risk auditee as that term is defined in OMB Circular A-133.

PART II – FINANCIAL STATEMENT FINDINGS SECTION

No matters were reportable.

PART III – FEDERAL AWARD FINDINGS AND QUESTIONED COST SECTION

No matters were reportable.



Ann Arbor Transportation Authority
2700 South Industrial Highway
Ann Arbor, Michigan 48104
734-973.6500 734-973.6338 F
<http://theride.org/>

.....
ANN ARBOR TRANSPORTATION AUTHORITY

**OMB CIRCULAR A-133
CORRECTIVE ACTION PLAN
YEAR ENDED SEPTEMBER 30, 2004**

There are no reportable instances of noncompliance. Therefore, no corrective action plan is considered necessary.

A handwritten signature in black ink, appearing to read 'Christopher White'.

Christopher White
Manager of Service Development
Compliance Officer

December 2, 2004

ANN ARBOR TRANSPORTATION AUTHORITY

**SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
YEAR ENDED SEPTEMBER 30, 2003**

No reportable prior audit findings.



REHMANN ROBSON

Certified Public Accountants

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December 2, 2004

Members of the Board of Directors
Ann Arbor Transportation Authority
Ann Arbor, Michigan

We have audited the basic financial statements of the ***Ann Arbor Transportation Authority*** as of and for the years ended September 30, 2004 and 2003, and have issued our report thereon dated December 2, 2004. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility under Generally Accepted Auditing Standards and OMB Circular A-133

As stated in our engagement letter dated October 14, 2004, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance that the basic financial statements are free of material misstatement. Because of the concept of reasonable assurance and because we did not perform a detailed examination of all transactions, there is a risk that material errors, fraud, or other illegal acts may exist and not be detected by us.

In planning and performing our audit, we considered the Ann Arbor Transportation Authority's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide assurance on the internal control over financial reporting. We also considered internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

As part of obtaining reasonable assurance about whether the Ann Arbor Transportation Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit. Also, in accordance with OMB Circular A-133, we examined, on a test basis, evidence about the Ann Arbor Transportation Authority's compliance with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* applicable to each of its major federal programs for the purpose of expressing an opinion on the Ann Arbor Transportation Authority's compliance with those requirements. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on the Ann Arbor Transportation Authority's compliance with those requirements.

Significant Accounting Policies

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we advised management about the appropriateness of accounting policies and their application. The significant accounting policies used by the Ann Arbor Transportation Authority are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2003-2004.

We noted no transactions entered into by the Ann Arbor Transportation Authority during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you. We noted no transactions for which there is a lack of authoritative guidance or consensus.

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

- Management's estimate of the liability for medical and life insurance benefits for eligible retirees are determined actuarially. We evaluated the qualifications of the actuaries and found them to be acceptable, and the actuarial report to be complete and consistent with prior years' calculations and within our expectations.
- Management's estimate of the useful lives of depreciable capital assets is based on the length of time it is believed that those assets will provide some economic benefit in the future. We evaluated the key factors and assumptions used to develop the useful lives of those assets in determining that they are reasonable in relation to the financial statements taken as a whole.

Significant Audit Adjustments

For purposes of this letter, professional standards define a significant audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. These adjustments may include those proposed by us but not recorded by the Ann Arbor Transportation Authority that could potentially cause future financial statements to be materially misstated, even though we have concluded that such adjustments are not material to the current financial statements. We proposed no audit adjustments that could, in our judgment, either individually or in the aggregate, have a significant effect on the Ann Arbor Transportation Authority.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Issues Discussed Prior to Retention of Independent Auditors

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Ann Arbor Transportation Authority's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing our audit.

This report is intended solely for the information and use of management, others within the organization, the Board of Directors, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

A handwritten signature in cursive script, reading "Lehmann Johnson".

THE ANN ARBOR TRANSPORTATION AUTHORITY

Comments and Recommendations

For the Year Ended September 30, 2004

During our audit we became aware of certain matters that are opportunities for strengthening internal control and meeting statutory laws. This memorandum summarizes our comments and recommendations regarding those matters. A separate report dated December 2, 2004 contains our report on the City's basic financial statements. This memorandum does not affect our report dated December 2, 2004, on the financial statements of the Ann Arbor Transportation Authority.

We will review the status of these comments during our next audit engagement. We have already discussed these matters with the Authority's management and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist the Authority in implementing the recommendations.

BANK ACCOUNT RECONCILIATIONS (Repeat comment)

All of the financial and accounting functions are either performed by or overseen by the Controller/Chief Financial Officer, which is not unusual for similar sized entities. These functions include preparing journal entries and investing money, as well as reconciling the bank statements to the general ledger on a monthly basis.

In order to enhance internal controls in this area, we recommend that the Authority consider having these monthly bank reconciliations reviewed for reasonableness by another accountant within the Department, and to document this review by initialing and dating the bank reconciliations.

CREDIT CARD POLICY UPDATE

Certain employees of the Authority are granted use of credit cards to obtain office supplies and other nominal items for the benefit of the Authority. We would like to commend the Authority for adopting a written policy during the year ended September 30, 2004.

We tested several transactions involving credit cards, and found that certain charges had a purchase order or order request form filled out after the purchase was made, which is inconsistent with the credit card policy and procedure which requires the approval by the department manager before the purchase is made.

We recommend that all purchases have the approval indicated by the department manager on the applicable form before the purchase is made in order to ensure the integrity of this credit card system.

INVENTORY SYSTEM

We noted that the repair parts line item over-expended its budget of \$606,100 by \$285,069, or 47%. Included was an adjustment for RTS parts inventory of \$130,000 to reflect parts disposed of since they were no longer required as the Authority eliminated the RTS buses from service. However, there was an inventory adjustment at year-end of \$120,536 making up most of the excess expenditure, as the inventory balance sheet account was adjusted to the actual inventory valuation.

THE ANN ARBOR TRANSPORTATION AUTHORITY

Comments and Recommendations (Concluded)

For the Year Ended September 30, 2004

In order to reduce the effect of large inventory adjustments at the end of the year and in order to monitor actual inventory shrinkage, we recommend that the Authority change its method of recording inventory purchases. Presently, inventory purchases are charged directly to the repair parts expense account at the time of purchase (the purchase method of accounting for inventory). The inventory is then adjusted at the end of the year to the actual inventory valuation. We recommend that inventory accounting method be changed to the consumption method, whereby inventory purchases are charged to an inventory account. When the parts or supplies are used, the inventory account is relieved and the expense account is charged. This will enable the repair parts to be expensed when consumed rather than when purchased throughout the year. This will enable the Authority to monitor actual inventory variances once the annual physical inventory is taken, and provide for more manageable year-end inventory adjustments.

BENCHMARKING

As the Federal and State governments reduce grant funding, control of expenses and evaluation of internal processes and outcomes becomes more critical. Many entities within the governmental sector have used benchmarking techniques to evaluate their operations, and to continue and even better their services with the same resources. The technique used could take many forms. One that is commonly utilized is to perform the following:

- By department, determine the broad mission statement, and determine "critical success factors" which when achieved means that that department has accomplished its goals and mission. For example, a critical success factor for the maintenance area may include "Reduce down time of equipment that affects daily operations," or "Respond to service requests in a courteous and timely manner, with priority given to requests with public safety implications."
- Determine proposed efficiencies in departmental processes, and consider ways to enhance revenues. "Brainstorming" sessions could be conducted involving all departmental employees, in order to obtain their buy-in.
- Identify key performance indicators for each department, which enables the Authority to assess its progress on attainment of the critical success factors. For example, in the maintenance area, indicators may include "Average number of buses waiting for repair daily," or "Gallons of fuel used per fixed route and demand response mile," or "Annual inventory shrinkage as a percent of total repair parts expense."

There are numerous other areas within the Authority where these techniques could be applied.

* * * * *